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Quarterly FCPA Report: First Quarter 2011

2011 Starts with Steady Pace of Settlements and Flurry of Litigation

BY THE GLOBAL COMPLIANCE AND DISPUTES PRACTICE

I. Introduction

Following 2010's record year of Foreign Corrupt Practices Act ("FCPA") enforcement, 2011 began steadily with four company and seven individual defendants – one of which included a blockbuster forfeiture – and with a flurry of litigation activity challenging DOJ's prosecution theories and tactics. Individual defendants in various cases filed during 2009 and 2010 challenged long-standing definitions of key components of the FCPA. In total, there were four corporate settlements of U.S. Securities and Exchange Commission ("SEC") charges, two of which also entered into deferred prosecution agreements with the U.S. Department of Justice ("DOJ"). There were also five guilty pleas, two sentencing decisions, and one settlement with the SEC by individual defendants.

The increased litigation by individuals has focused on the definition of "foreign official" under the FCPA. In the case of *United States v. Noriega et al*, [1] defendants argued that the FCPA does not apply to employees and officers of foreign state-owned entities, specifically Mexico's state-owned utility company, CFE. Relying on the Mexican Constitution and statutory law as factual evidence, U.S. District Court Judge for the Central District of California A. Howard Matz held that CFE officials fall under the dictionary-definition of "instrumentality" of a foreign government, making them "foreign officials" under the FCPA. Judge Matz denied defendants' motion to dismiss, and the case will now go to trial. Meanwhile, the same defense is being argued in *United States v. Carson et al*[2] (also in the Central District of California) and in *United States v. O'Shea*[3] in the Southern District of Texas. The *Noriega* ruling along with the respective motions and potential rulings from *Carson* and *O'Shea* have the potential either to change the way the FCPA is enforced or strengthen the DOJ prosecution theories.

The first quarter of 2011 also saw groundbreaking enforcement of the FCPA against individuals. Jeffrey Tesler, central to the TSKJ-Bonny Island consortium, agreed to forfeit nearly $149 million, the largest FCPA-related forfeiture by an individual to date. Additionally, two defendants pleaded guilty in the high-profile arms contract case, the largest FCPA enforcement action against individuals, with twenty-two indicted defendants. The immensity of Tesler's fine as well as the scope of the twenty-two-defendant arms contract case, show the government's continued focus on prosecuting individuals for FCPA violations.

The corporate settlements of this first quarter illustrate the government's current focus on foreign subsidiaries and joint ventures of U.S. companies. All four settlements involved related foreign entities and included claims of failure to implement and maintain an effective system of internal controls. In three of these cases – Ball Corp., Tysons, Inc., and Maxwell Technologies – internal concerns had

been raised to management, however, the DOJ and SEC claimed in each that the companies' reactions to these warnings were not sufficient.

At the end of the quarter, the United Kingdom Ministry of Justice released its guidance on the UK Bribery Act, and the law will go into effect July 1, 2011. Paul Hastings released the first of a series of Client Alerts regarding the Act and the guidance issued (found here).

II. Four Recent Corporate Enforcement Actions

A. Maxwell Technologies – Inflated Invoices in China

On January 31, 2011, the DOJ resolved charges against Maxwell Technologies for violating the FCPA's anti-bribery provisions and the books and records provisions by entering into a three-year deferred prosecution agreement ("DPA"). The SEC also settled civil charges against Maxwell for failure to devise and maintain an effective system of internal controls and for improperly recording the unlawful payments on its books. Maxwell will pay $8 million in criminal penalties. The company must also implement an enhanced compliance program and internal controls capable of preventing and detecting FCPA violations and must cooperate with the DOJ in the continuing investigation. To resolve the SEC's civil charges, Maxwell will forfeit a combined $6.3 million in disgorgement and prejudgment interest.

Maxwell Technologies produces energy-storage and power delivery technology, and is headquartered in San Diego, California. Between July 2002 and May 2009, a Swiss subsidiary of Maxwell engaged a Chinese agent to sell Maxwell's products in China. According to the DPA, the agent was paid approximately $2.8 million, which was then allegedly distributed to Chinese foreign officials in return for securing contracts for Maxwell. To achieve this, the agent would allegedly invoice the Chinese companies an extra twenty-percent. The agent would then invoice Maxwell for this extra amount and would pass the payments from Maxwell to officials at the Chinese state-owned companies. As a result, the DPA states that Maxwell obtained contracts earning it $15 million in revenue and $5.6 million in profits. These payments were brought to management's attention in 2002 by an employee, but, according to the DPA, Maxwell management responded that it was a "well know[n] issue" and instructed that there be "[n]o more emails please."

Maxwell later voluntarily disclosed these actions and cooperated with the DOJ and SEC. In the DPA, the DOJ acknowledged that the criminal penalty is twenty-five percent below the bottom of the applicable Sentencing Guidelines range of $10.5 million because of these disclosures and Maxwell's commitments contained in the DPA.

B. Tyson Foods, Inc. – Spouses in Mexico

On February 10, 2011, the DOJ announced it had entered into a DPA with Tyson Foods, Inc., relating to charges of illegal payments by the company to government-employed inspection veterinarians in Mexico. The SEC also settled charges with Tyson. Tyson will be required to pay a $4 million criminal penalty, implement internal controls, and cooperate with the DOJ. The settlement with the SEC requires Tyson to make a $1.2 million payment for disgorgement of profits and pre-judgment interest.

Tyson produces meat products, including chicken, beef, pork, and prepared foods and has a wholly-owned subsidiary in Mexico – Tyson de Mexico. Mexico requires all food-processing plants to pass certain inspections conducted by government-employed veterinarians. These veterinarians ensure that all exports conform to the Mexican health and safety laws.

According to the DPA, in 2004, Tyson de Mexico's plant manager discovered that the wives of two veterinarian inspectors were on the company's payroll. The plant manager informed a Tyson Foods

accountant of the situation. After meetings between Tyson Foods and Tyson International, a Tyson International executive allegedly approved a plan to replace these payroll payments with invoice payments directly to one of the veterinarians. The DPA states that this practice continued until 2006, when counsel for Tyson Foods instructed Tyson de Mexico to stop making the invoice payments.

Tyson was charged with conspiracy to violate the FCPA and violating the FCPA. In their DPA, Tyson admitted that employees and agents at its subsidiaries had made improper payments totaling over $100,000 between 2004 and 2006 to veterinarians who inspected its chicken processing plants headquartered in Gomez Palacio, Mexico. According to court filings, Tyson Foods realized a net profit of over $880,000 from export sales from its Tyson de Mexico facilities from 2004-2006.

In addition to the improper payments, the government noted that Tyson had an insufficient system of internal controls that failed to detect or prevent the misconduct. The SEC also stated that Tyson failed to implement a system of effective internal controls to prevent the salary payments to phantom employees and the payment of illicit invoices.

C. IBM – Bags of Cash and Vacations in Korea and China

On March 18, 2011, International Business Machines ("IBM") consented to the entry of final judgment relating to charges by the SEC of violating the books and records and internal controls provisions of the FCPA. Though IBM did not admit or deny the allegations, the judgment enjoins IBM from violating these provisions of the FCPA and requires the company to pay disgorgement of $5.3 million, $2.7 million in prejudgment interest, and a $2 million civil penalty.

The charges allege that from 1998 to 2003, employees of IBM Korea, Inc., an IBM subsidiary, and LG IBM PC Co., Ltd., a joint venture in which IBM held a majority interest, made improper cash payments and provided gifts, travel, and entertainment to government officials in South Korea. It is alleged that a total of $207,000 in cash was paid to these officials to secure the sale of IBM products. The resulting benefit to IBM included approximately $32.7 million in contracts for IBM Korea as well as a $21 million contract for an IBM Korea business partner.

It was further alleged that from 2004 to 2009, over 100 employees of IBM (China) Investment Co. Ltd. and IBM Global Services (China) Co., Ltd., both wholly-owned IBM subsidiaries, engaged in a widespread practice of providing overseas trips, entertainment, and improper gifts to Chinese government officials. These payments were recorded as legitimate business expenses, resulting in the books and records charge. The SEC stated in its charge that IBM lacked sufficient internal controls designed to prevent or detect these violations of the FCPA.

D. Ball Corporation – Acquisition in Argentina

On March 24, 2011, Ball Corporation consented to the SEC's entry of a cease-and-desist order against the company and, without admitting or denying the SEC's allegations, agreed to pay a $300,000 civil penalty. The SEC alleged that from July 2006 through October 2007, Ball's wholly-owned subsidiary, Formametal S.A., made payments totaling $106,749 to employees of the Argentine government to circumvent customs and tariff laws.

Ball is an Indiana corporation based in Broomfield, Colorado which manufactures metal packaging for food, beverage, and household products. Ball acquired Formametal in March 2006. In June 2006, a Ball financial analyst allegedly discovered that Formametal may have made questionable payments in the past. The analyst submitted this report to senior executives at Ball. The SEC further alleged that following this report, from July 2006 to October 2007, ten unlawful payments were authorized by

Formametal's senior officers. These payments were allegedly made to induce government customs officials to circumvent Argentine laws prohibiting the importation of used equipment and parts and to avoid high duties on the exportation of copper and copper scraps.

The SEC determined that the alleged unlawful payments show that Ball's actions following the warnings of the analyst were insufficient, resulting in the Commission's charge of failure to devise and maintain an effective system of internal controls to prevent and detect violations of the FCPA. Additionally, the alleged nature of these payments was mischaracterized on Formametal's books and records. Because Formametal's financial statements were consolidated with those of Ball, the SEC charged Ball for failure to keep accurate books and records in violation of the FCPA.

III. Seven Recent Individual Enforcement Actions

A. Leo W. Smith – Pacific Consolidated Industries

It was reported in January that on December 6, 2010, Leo W. Smith, former director of sales and marketing for Pacific Consolidated Industries, was sentenced to six months in prison followed by six months of home confinement. He will also have three years of supervised release and must pay a $7,500 fine. The DOJ had recommended a thirty-seven month prison sentence.

Smith pleaded guilty in September 2009 to charges of conspiracy to violate the FCPA and corruptly obstructing and impeding the due administration of the internal revenue laws. The DOJ brought these charges after Smith and PCI's former president allegedly paid over $70,000 to an official at the U.K. Ministry of Defense through sham consulting agreements in return for $11 million in contracts. Smith's co-conspirator, Martin Eric Self, was sentenced in 2008 to two years probation, while the U.K. official involved was sentenced to two years in prison.

B. Manuel Salvoch – Latin Node, Inc.

On December 17, 2010, Manuel Salvoch, former CFO of Latin Node, Inc. ("Latinode"), was charged with conspiracy to violate the FCPA, and he pleaded guilty on January 12, 2011. Salvoch faces up to five years in prison and a $250,000 fine.

In 2009, Latinode pleaded guilty and admitted to making over $1 million in payments to the Honduran state-owned telecommunications company, Hondutel. These payments were made to obtain an interconnection agreement with Hondutel and for a reduction of the per-minute-rate in the agreement. Mr. Salvoch was charged with conspiring with other Latinode executives and with making unlawful payments to Hondutel officials. Two other Latinode executives were also charged in December for their alleged involvement – Jorge Granados, founder and former CEO and Chairman of Latinode, and Manuel Caceres, former Vice President of Business Development. Their trial is scheduled for September 2011.

C. Paul W. Jennings – Innospec, Inc.

On January 24, 2011, the SEC settled an enforcement action against Paul W. Jennings, former CFO and CEO of Innospec, Inc., for falsely certifying that he had complied with Innospec's FCPA compliance policy. Jennings will pay disgorgement of $116,092, prejudgment interest of $12,045, and an additional civil penalty of $100,000. The SEC stated that Jennings' penalties take into account his cooperation. The final judgment also enjoins him from violating the FCPA and from aiding and abetting Innospec in violating the FCPA.

Innospec manufactures and distributes fuel additives and other specialty chemicals. The government alleged that from 2000 to 2008, Innospec made payments to government officials in Iraq and Indonesia to sell TEL, a fuel additive which boosts the octane level of gasoline. This began with Innospec's participation in the United Nations Oil for Food Program in 2000. In total, Innospec made approximately $6.3 million in payments and promised an additional $2.8 million in exchange for contracts worth approximately $176 million. In March 2010, Innospec pleaded guilty to charges by the DOJ for violating the FCPA and to related charges brought by the United Kingdom's Serious Fraud Office. Innospec also settled a civil claim brought by the SEC for violating the FCPA.

Jennings' involvement began in 2004 when he became head of the TEL unit and learned of the company's payments to foreign government officials. He became interim CEO that year and permanent CEO and President in 2005 and allegedly approved payments to the Iraqi Ministry of Oil in order to sell TEL. Innospec's actions allegedly included a two-percent kickback paid through a local agent, payments to officials at the Trade Bank of Iraq in exchange for favorable exchange rates on letters of credit, and payments to ensure the failure of a field test of a competitor product. Jennings also began approving payments to Indonesian officials in 2004. Innospec also allegedly made a "one off" payment of $300,000 to Innospec's Indonesian Agent which was intended to be passed on to an Indonesian official.

Beginning in 2004, Jennings signed annual certifications stating he had complied with Innospec's Code of Ethics incorporating the Company's Foreign Corrupt Practices Act policy and signed certifications pursuant to the Sarbanes-Oxley Act in which the government claims he made false certifications concerning the company's books and records and internal controls. These false certifications were the basis for the SEC complaint.

D. Antonio Perez – Haiti Telephone

On January, 21, 2011, Antonio Perez was sentenced to two years in prison, two years of supervised release, and ordered to forfeit $36,375. Perez, the controller of a Florida telecommunications company, allegedly conspired to make corrupt payments to Haitian officials to secure contracts and other favorable treatment. Perez's co-conspirators included Robert Antoine, the former Director of International Relations for the state-owned Telecommunications D'Haiti and Juan Diaz, the owner of J.D. Locator Services, among others.

The DOJ alleged that between November 2001 and March 2005, Perez and his co-conspirators concealed improper payments by conducting financial transactions involving shell companies and mislabeling invoices, checks, and ledgers. Perez admitted arranging payments of $674,193 to Haitian officials and personal involvement in two corrupt payments totaling $36,375, by causing checks to be issued to J.D. Locator. On April 27, 2009, Perez pleaded guilty to conspiracy to violate the FCPA and money laundering.

E. Daniel Alvirez – Arms Contract Case

On March 1, 2011, Daniel Alvirez pleaded guilty of two counts of conspiracy to violate the FCPA. Alvirez was the president of ALS Technologies, an Arkansas company that manufactures and sells law enforcement and military equipment.

Following Richard Bistrong's plea in September 2010, Alvirez became the second individual to plead guilty in the high profile arms contract case, the largest single undercover investigation and prosecution against individuals in the history of DOJ enforcement of the FCPA. The unsealed superseding grand jury indictment alleged that between May and December of 2009, Alvirez and

twenty-one others participated in corrupt deals to sell products including ammunition and body armor to the governments of Gabon and Georgia. The defendants allegedly agreed to pay a twenty-percent "commission" to a sales agent, who the defendants believed represented the minister of defense for a country in Africa, in order to win a portion of a $15 million deal to supply the country's presidential guard. The defendants were allegedly told that half of the "commission" would be paid directly to the Georgian Minister of Defense. The agreements were part of an undercover operation, and no foreign minister of defense was involved. The sixteen indictments were unsealed on January 19, 2010, when the twenty-two defendants were arrested.

F. Jeffrey Tesler – Blockbuster Forfeiture

On March 11, 2011, Jeffrey Tesler pleaded guilty to one count of violating the FCPA and one count of conspiring to violate the FCPA. As part of the plea agreement, Tesler forfeited nearly $149 million, the largest forfeiture by an individual related to FCPA violations to date. Tesler was indicted in February 2009 and charged with one count of conspiracy to violate and ten counts of violating the FCPA. In March of 2010, London-based Tesler was extradited to the United States.

Under the plea agreement, Tesler acknowledged that he controlled Tri-Star Investments, a Gilbraltar corporation that consulted for the TSKJ joint venture and acted as agent to TSKJ, M.W. Kellogg Company, and Kellogg, Brown & Root, Inc. The plea agreement disclosed that, from 1994 through June 2004, Tesler conspired with TSKJ and then-CEO of Kellogg, Brown & Root, Albert Jackson Stanley, to pay roughly $132 million in unlawful payments to Nigerian government officials to secure their support for TSKJ's participation in the project to build liquefied natural gas facilities at Bonny Island. The Bonny Island contracts were valued at over $6 billion.

Tesler, who is to be sentenced on June 22, 2011, faces up to ten years in prison.

G. Jonathan Spiller – Arms Contract Case

On March 29, 2011, Jonathan Spiller became the third defendant in the high profile arms contract case to plead guilty when he admitted to conspiring to violate the FCPA. Spiller was the CEO of Armor Holdings, a Florida company that provides consulting services to companies in the law enforcement and military equipment industry.

The unsealed grand jury indictment alleges that in May 2009, Spiller met with an individual he believed to be an agent of the Minister of Defense of Gabon. At the meeting Spiller allegedly agreed to pay a twenty-percent "commission" to the agent, ten-percent of which would go directly to the Minister of Defense, in exchange for Spiller's company being awarded a contract to supply the Presidential guard with weapons. The contract was to be worth roughly $15 million. In fact, the "agent" of the Defense Minister was an undercover FBI agent and the Defense Minister had no involvement in the investigation. Under the plea agreement, Spiller faces up to five years in prison.

IV. Conclusion

The increased FCPA enforcement of 2010 has not abated in the first quarter of 2011. A steady and continuing level of enforcement activity reminds us how important it is for companies to implement adequate compliance programs and review and update as needed based on enforcement developments. The DOJ and SEC's activities this quarter focus on acquisitions, foreign subsidiaries, and joint ventures in traditionally difficult anti-corruption markets (China, Korea, Mexico and Argentina) and signals that the enforcement authorities require even more diligence from U.S. companies involved in such arrangements to ensure their monitoring programs are sufficient to identify and correct improper actions. With additional countries implementing their own anti-bribery

laws, especially the UK Bribery Act, a commitment to anti-corruption policies is essential for U.S. and foreign companies working abroad. Whether there will be additional judicial decisions addressing the DOJ's interpretation of the definition of "foreign official," the undercover tactics in the arms contract case, or the FBI search warrant tactics in the Lindsey case should be answered in the second quarter of 2011.

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[1] *U.S. v. Noriega et al*, No. 10-1031 (C.D. Cal. filed Oct. 21, 2010).
[2] *U.S. v. Carson et al*, No. 09-077 (C.D. Cal. filed Apr. 8, 2009).
[3] *U.S. v. O'Shea*, No. 09-629 (S.D. Tex. filed Nov. 16, 2009)